

Attachment 3

PCAOB's Description of the Development Process for Auditing Standard No.

3

PCAOB Release No. 2004-006, June 9, 2004, pages 1-3

The Board commenced a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003, to discuss issues and hear views on audit documentation. Before that roundtable discussion, the Board prepared and released a briefing paper on audit documentation, which posed several questions to help identify the objectives – and the appropriate scope and form – of audit documentation. In addition, the Board asked participants to address specific practice issues relating to, among other things, changes in audit documentation after an audit report has been released; the essential elements and the appropriate amount of detail of audit documentation; the effect on audit documentation of a principal auditor's decision to use the work of other auditors; and retention of audit documentation.

Taking into consideration comments from participants in this roundtable discussion, the advice from the Board's staff, and other input, the Board determined that the existing interim auditing standard on audit documentation was not sufficient in providing direction to ensure that auditors appropriately document both the work they perform and the conclusions they reach in connection with audits and other engagements. On November 21, 2003, the Board issued a proposed auditing standard entitled *Audit Documentation*, as well as a related amendment to an interim auditing standard (paragraph .12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*).

The Board received 38 comment letters from a variety of interested parties, including auditors, regulators, professional associations, and government agencies. Those comments led to some changes in the requirements of the standard.

The Board's standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work that the auditor performed, the evidence gathered, and the conclusions reached. Meaningful review by managers and partners, or by the Board in the context of its inspections, would be difficult, if not impossible, without adequate documentation. Clear and comprehensive audit documentation is essential for auditors to enhance the quality of the audit and for the Board to fulfill its mandate to inspect registered public accounting firms "to assess the degree of compliance" of those firms with applicable standards and laws.

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Summary of Audit Documentation Requirements

Existing Sec. 5097 – Audit Documentation Requirements	CalCPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
<p>(a) Audit documentation shall be a licensee's records of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in an audit engagement. Audit documentation shall include, but is not limited to, programs, analyses, memoranda, letters of confirmation and representation, copies or abstracts of company documents, and schedules or commentaries prepared or obtained by the licensee.</p> <p>(b) Audit documentation shall contain sufficient documentation to enable a reviewer with relevant knowledge and experience, having no previous connection with the audit engagement, to understand the nature, timing, extent, and results of the auditing or other procedures performed, evidence obtained, and conclusions reached, and to determine the identity of the persons who performed and reviewed the work.</p> <p>(c) Failure of the audit documentation to document the procedures applied, tests</p>	<p>No proposed changes to Business and Professions Code Section 5097.</p>	<p>The auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed, the audit evidence obtained and its source, and the conclusions reached.</p> <p>Audit documentation, also known as working papers or workpapers, maybe recorded on paper or on electronic or other media.</p> <p>Audit documentation includes audit programs, analyses, issues memorandums, summaries of significant findings and issues, letters of confirmation and representation, checklist, abstracts of important documents, correspondence (including e-mail) concerning significant findings and issues, discussions of significant findings or issues with management (including when and with whom the discussions took place) and schedules of the work the auditor performed.</p>	<p>The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions. Audit documentation must clearly demonstrate that the work was in fact performed. The audit documentation should be appropriately organized to provide a clear link to the significant findings and issues. Audit documentation includes memoranda, confirmations, correspondence, schedules, audit programs and letters of representation.</p> <p>Documentation of auditing procedures that involve the inspection of documents or confirmations, including tests of details, tests of operating effectiveness of controls and walkthroughs, should include identification of the items inspected. Documentation of auditing procedures related to the inspection of significant contracts or agreement should include abstracts or copies of the documents.</p>

Summary of Audit Documentation Requirements

Existing Sec. 5097 – Audit Documentation Requirements	CalCPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
<p>performed, evidence obtained, and relevant conclusions reached in an engagement shall raise a presumption that the procedures were not applied, tests were not performed, information was not obtained, and relevant conclusions were not reached. This presumption shall be a rebuttable presumption affecting the burden of proof relative to those portions of the audit that are not documented as required in subdivision (b). The burden may be met by a preponderance of the evidence.</p>	<p>tests of operating effectiveness of controls and substantive tests of details that involve inspection of documents or confirmation should include the identifying characteristics of the specific items tested.</p> <p>The auditor should document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the final conclusions reached.</p>	<p>tests of operating effectiveness of controls and substantive tests of details that involve inspection of documents or confirmation should include the identifying characteristics of the specific items tested.</p> <p>The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the final conclusions reached.</p> <p>If the auditor departs from a presumptively mandatory requirement, the auditor must document his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement.</p>	<p>The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement.</p>

Note: Substantive content of SAS No. 103 & PCAOB A.S. No. 3 is very similar. B&P 5097 contains parallel content in relation to its description of audit documentation but has material added content in areas a) knowledgeable reviewer being able to understand and b) the rebuttable presumption (if work is not documented, it will be presumed to have not been done.)

Summary of Audit Documentation Requirements

Existing Sec. 68.2 – Identification of Audit Documentation	CaICPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
<p>(b) ...audit documentation shall provide the date the document or working paper was completed by the preparer(s) and any reviewer(s), and shall include the identity of the preparer(s) and any reviewer(s).</p> <p>(c) Audit documentation shall include both the report date¹ and the date of issuance of the report².</p>	<p>No proposed changes to Section 68.2.</p>	<p>In documenting the nature, timing, and extent of audit procedures performed the auditor should record:</p> <ul style="list-style-type: none"> (a) Who performed the audit work and the date such work was completed; and (b) Who reviewed specific audit documentation and the date of such review. 	<p>Audit documentation must contain information on who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.</p>

Note: Sec. 68.2, A.S. No. 103, & PCAOB A.S. No. 3 are all similar in content requiring identity of preparer(s), reviewer(s) and date work completed. Sec. 68.2 add specific requirement that report date and report date of issuance be documented.

¹ The auditor's report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion. (In majority of audits, the report date is the date of completion of the audit fieldwork.)

² Date of issuance (report release date) will be the date the auditor delivers the audit report to the audit client.

Summary of Audit Documentation Requirements

Existing Sec. 68.4 – Changes in Audit Documentation After Issuance of the Report	AICPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
<p>(a) Changes in audit documentation include any addition, removal, deletion, substitution, or editing of audit documentation, including but not limited to, physical or electronic additions to any audit documentation, occurring after the date of issuance of the audit report which is supported in whole or in part by the audit documentation.</p> <p>(b) Except as provided in subsection (c), in addition to any other documentation required by professional standards, any changes in audit documentation shall provide the identity of the person(s) making the change, and identity of any person(s) approving the change, the date of the change, and the reason for the change if the reason is other than assembling of pre-existing documents. The documentation which is changed shall contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the engagement, to understand the</p>	<p>(a) <u>Changes in audit documentation include any addition, removal, deletion, substitution, or editing of audit documentation, including but not limited to, physical or electronic additions to any audit documentation, occurring after the date of issuance of the audit report which is supported in whole or in part by the audit documentation. Prior to the date of issuance of the report, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report.</u></p> <p>(b) <u>Except as provided in subsection (c), in addition to any other documentation required by professional standards, any changes in audit documentation shall provide the identity of the person(s) making the change, and identity of any person(s) approving the change, the date of the change, and the reason for the change if the reason is other than assembling of pre-existing documents. The documentation which is changed shall contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the engagement, to understand the</u></p>	<p>The auditor should complete the assembly of the final audit file on a timely basis, but within 60 days following the report release date (documentation completion date).</p> <p>At anytime prior to the documentation completion date, the auditor may make changes to the audit documentation to:</p> <ul style="list-style-type: none"> (a) Complete the documentation and assembly of audit evidence that the auditor has obtained, discussed and agreed with relevant members of the audit team prior to the date of the auditor's report; (b) Perform routine file-assembling procedures such as deleting or discarding superseded documentation and sorting, collating, and cross-referencing final working papers; (c) Sign off on file completion checklists prior to completing and archiving the audit file; and (d) Add information received after the date of the auditor's report, for example an original confirmation that was previously faxed. <p>The report release date should be</p>	<p>Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date no more than 45 days after the report release date (documentation completion date). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed, if the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased.</p> <p>Circumstances may require additions to audit documentation after the report release date. Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added. Any documentation added must indicate the date the information was added, the name of</p>

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<p>nature, timing, reason for, and extent of the change.</p> <p>(c) During a 60-day period after the date of issuance of the audit report, documents may be added to the file for assemblage and documentation of work previously performed. Nothing in this subsection authorizes the deferral of audit procedures required to be performed prior to the date of issuance of the report.</p>	<p><u>unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased.</u></p> <p>(b) <u>Circumstances may require additions to audit documentation after the date of issuance of the report.</u> Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added.</p> <p>Except as provided in subsection (c), in addition to any other documentation required by professional standards, any changes in audit documentation added must indicate the date the information was added, the name of the person who prepared the additional documentation, shall provide the identity of the person(s) making the change, and the identity of any person(s) approving the change.</p> <p>In addition, the date of the change, and the reason for adding it, the change if the</p>	<p>recorded in the audit documentation.</p> <p>After the documentation completion date, the auditor must not delete or discard audit documentation before the end of the specified retention period. When the auditor finds it necessary to make an addition (including amendments) to audit documentation after the documentation completion date, the auditor should document the addition.</p>	<p>the person who prepared the additional documentation, and the reason for adding it.</p>

Summary of Audit Documentation Requirements

Existing Sec. 68.4 – Changes in Audit Documentation After Issuance of the Report	CaICPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
	<p>Reason is other than assembling of pre-existing documents. The documentation which is changed <u>added</u> shall contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the engagement, to understand the nature, timing, reason for, and extent of the change <u>addition</u>.</p> <p>(e) During a 60-day period after the date of issuance of the audit report, documents may be added to the file for assembly and documentation of work previously performed. Nothing in this subsection authorizes the deferral of audit procedures required to be performed prior to the date of issuance of the report.</p>		

Note: SAS No. 103 & PCAOB No. 3 are materially the same except for duration of window period between report release date and documentation completion date. Thereafter only additions allowed but must be clearly documented.

Sec. 68.4 allows changes (including deletions) after report release date only if clearly documented.

Summary of Audit Documentation Requirements

Existing Sec. 68.3 – Retention Period for Audit Documentation	CalCPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
<p>(a) The retention period mandated by Business and Professions Code section 5097 [seven years] shall be measured from the report date.¹</p> <p>(b) If audit documentation is required to be kept for longer than seven years because of a pending Board investigation or disciplinary action, audit documentation shall not be destroyed until the licensee has been notified in writing by the Board of closure of a Board investigation or disciplinary proceeding.</p> <p>(c) Any documents required to be maintained by Business and Professions Code Section 5097 or these regulations shall be maintained in accessible form.</p> <p>(d) Audit documentation shall be retained whether or not the documentation supports the auditor's final conclusions. All</p>	<p>(a) The retention period mandated by Business and Professions Code section 5097 shall be measured from the report date of issuance of the report.</p> <p>(b) If audit documentation is required to be kept for longer than seven years because of a pending Board investigation or disciplinary action, audit documentation shall not be destroyed until the licensee has been notified in writing by the Board of closure of a Board investigation or disciplinary proceeding.</p> <p>(c) Any documents required to be maintained by Business and Professions Code Section 5097 or these regulations shall be maintained in accessible form.</p> <p>(d) Audit documentation shall be retained whether or not the documentation supports the auditor's final conclusions. All</p>	<p>The auditor should adopt reasonable procedures to retain and access audit documentation for a period of time sufficient to meet the needs of his or her practice to satisfy any legal or regulatory requirements for records retention. Such period, however, should not be shorter than five years from the report release date.²</p>	<p>The auditor must retain audit documentation for seven years from the date the auditor grants permission to use the auditor's report in connection with issuance of the company's financial statements (report release date), unless a longer period is required by law. If a report is not issued in connection with an engagement, then the audit documentation must be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the audit documentation must be retained for seven years from the date the engagement ceased.</p>

¹ The auditor's report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion. (In majority of audits, the report date is the date of completion of the audit fieldwork.)

² Date of issuance (report release date) will be the date the auditor delivers the audit report to the audit client.

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Existing Sec. 68.3 – Retention Period for Audit Documentation	CalCPA's Proposal	AICPA Statement on Auditing Standards No. 103	PCAOB Auditing Standard No. 3
	<p>audit documentation regarding any significant matter related to the audit shall be retained whether or not the documentation contains information or data inconsistent with the auditor's final conclusions. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Audit documentation to be retained shall also include all documentation of consultation on, or resolutions of, any differences of opinion regarding the exercise of professional judgment.</p>	<p>any significant matter related to the audit shall be retained whether or not the documentation contains information or data inconsistent with the auditor's final conclusions. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Audit documentation to be retained shall also include all documentation of consultation on, or resolutions of, any differences of opinion regarding the exercise of professional judgment.</p>	<p>any significant matter related to the audit shall be retained whether or not the documentation contains information or data inconsistent with the auditor's final conclusions. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Audit documentation to be retained shall also include all documentation of consultation on, or resolutions of, any differences of opinion regarding the exercise of professional judgment.</p>

Note:

- Retention period is different for all three standards.
- Sec. 68.3 requires seven years measured from report release date.
- A.S. No. 103 requires five years measured from report release date.
- PCAOB A.S. No. 3 requires seven years measured from report release date.

Sec. 68.3 has added requirement that data inconsistent with auditor's final conclusions be retained.

Memorandum

Attachment 2

CPC Agenda Item II
May 18, 2006

Board Agenda Item IX.C.2
May 19, 2006

To : CPC Members
Board Members

Date: May 2, 2006
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From : Aronna Wong *[Signature]*
Legislation/Regulations Coordinator

Subject : Background Information Related to CalCPA's Request for Amendments to the Board's Regulations Related to Audit Documentation

Consideration of CalCPA's request for amendments to the Board's Regulations related to audit documentation is scheduled for the May 18, 2006, Committee on Professional Conduct (CPC) and the May 19, 2006, Board meetings. The text of CalCPA's proposal and a side-by-side comparison of related standards and rules are provided under a separate cover. This memo transmits the following additional background information:

- Excerpts from the Minutes of the November 17, 2005, CPC Meeting (Attachment A).
- A November 15, 2006, letter from Julianne D'Angelo Fellmeth of the Center for Public Interest Law (Attachment B).
- Business and Professions Code Sections 5097-5098 (Attachment C).
- Sections 68.2-68.5 of the Board's Regulations Related to Audit Documentation (Attachment D).
- PCAOB Auditing Standard No. 3 – Audit Documentation (Attachment E).
- SAS No. 103 Audit Documentation (Attachment F).

Attachments



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Attachment A



COMMITTEE ON PROFESSIONAL CONDUCT
MINUTES OF THE MEETING

FINAL

November 17, 2005
Delta King
1000 Front Street
Sacramento, CA 95815

CALL TO ORDER

The meeting of the Committee on Professional Conduct (CPC) was called to order at 10:05 a.m. by Ronald Blanc, Chair. Mr. Blanc indicated that to ensure compliance with the Bagley-Keene Open Meeting Act, when a quorum of the Board is present at this meeting (eight members of the Board), Board members who are not serving on the committee must attend as observers only. Ms. Sigmann introduced George Ritter, the Board's new legal counsel from the Department of Consumer Affairs.

Present:

Ronald Blanc, Chair
Richard Charney
Gail Hillebrand
Thomas Iino
Renata Sos
David Swartz

Staff and Legal Counsel

Mary Crocker, Assistant Executive Officer
Michael Granen, Deputy Attorney General
Patti Franz, Licensing Manager
Greg Newington, Chief, Enforcement Program
Dan Rich, Manager, Administrative Services
George Ritter, Legal Counsel
Theresa Siepert, Executive Analyst
Carol Sigmann, Executive Officer
Aronna Wong, Legislation/Regulations Coordinator

Other Participants

Maureen Blasko, Ernst and Young LLP
Michael Duffey, Ernst and Young LLP
Julie D'Angelo Fellmeth, Center for Public Interest Law